

## **THE LOCAL CHOICE PROGRAM**

### **Procedures for determining adverse experience adjustment**

Paragraphs 2.4.C and 3.9 of the regulations under which The Local Choice (TLC) program operates provide for an adverse experience adjustment to withdrawing employers. This adjustment requires any withdrawing employer to contribute its pro rata share of any operating loss experienced during prior plan years. Although the regulations permit a multi-year review of profits and losses, it is the policy of the Department to confine any applicable adverse experience adjustment to the experience of the last full fiscal year (July 1 through June 30) during which the employer was a member. The following illustrations have been prepared in order that our members can understand how the adverse experience adjustment would be calculated.

The bases for determining any adverse experience adjustment are (1) the amount of the program's loss for the most recent July 1 through June 30 plan year, (2) the experience of the employer, and (3) the proportion of the employer's enrollment to the enrollment of the entire category. Employers are divided into three categories.

1. Employers with under 50 enrollees (Pooled)
2. Employers with between 51 and 300 enrollees (Blended)
3. Employers with over 300 enrollees (Experience Rated)

A statement of income and expenses is prepared for each category based upon its experience. (The third category group is not really a category. It comprises experience rated employers who are each responsible for their claims, whether or not the "category" of self-insured employers sustains a loss.) It is possible that one category would experience a loss, subjecting the employers in that category group to an adverse experience adjustment, while another category would operate at a surplus, thus requiring no experience adjustment to withdrawing groups.

#### **EMPLOYERS WITH UNDER 300 ENROLLEES (CATAGORIES 1 & 2)**

The first step in the adjustment process is to determine the total number of contract units (C/Us) for each category for the past plan year. A contract unit is determined by the following factors applied to the type of membership for each enrollee: an employee only contract has one C/U; an employee plus one contract has two C/Us; a family contract has 2.8 C/Us. Therefore, the number of contracts by each membership type is accumulated, and the total contract units for that category is computed based on the stated factors as follows:

Type of <u>Membership</u>	Total <u>Contracts</u>	C/U <u>Factor</u>	Total <u>C/Us</u>
Employee only	4,500	1.0	4,500
Employee + One	2,200	2.0	4,400
Family	<u>3,300</u>	2.8	<u>9,240</u>
Total	10,000		18,140

## **THE LOCAL CHOICE PROGRAM**

### **Procedures for determining adverse experience adjustment- Continued**

The next step is to determine the total number of contract units for the withdrawing employer during the plan year using the same method illustrated above. The withdrawing employer's pro rata share of the contract units is then applied to the category's loss to determine the adverse experience adjustment for the withdrawing employer. The following example illustrates an adverse experience calculation for employers in categories 1 and 2.

#### **EXAMPLE:**

ASSUMPTIONS: Loss for the category is \$1,000,000. Total category contract units equals 18,140. The employer had 1,878 C/Us during the review year.

1. Employer's C/Us divided by category's C/Us equals employer's pro rata share.
2. Employer's share times the category's loss equals the employer's adverse experience adjustment.

**CALCULATIONS:**  $1,878 / 18,140 = 10.35\% \times \$1,000,000 = \$103,500$

In the example, the employer would have an adverse experience adjustment of \$103,500 at the time of termination. The terminating employer would be notified of this amount within 90 days of termination, and the employer would be required to pay the adjustment in up to 12 equal installments beginning 30 days after the notification by the Department.

#### **EMPLOYERS WITH OVER 300 ENROLLEES (CATEGORY 3)**

The maximum adverse experience amount which would be due from each terminating employer in this category would be that employer's loss during the immediate past plan year based upon the employer's plan(s) expenses and its pro rata share of the program overhead. Prior years' performance during which the employer was experience rated would be taken into consideration, if favorable to the employer, but the adverse experience adjustment would never exceed the past year's loss.

Thus, an employer in this category withdrawing at the end of a year in which it did not have a loss would have no adverse experience adjustment. Another employer which withdrew after having a \$100,000 loss during its last plan year would be subject to a maximum adverse experience adjustment of that \$100,000 loss paid in equal installments over a 12-month period. An illustration follows

**THE LOCAL CHOICE PROGRAM**  
**Procedures for determining adverse experience adjustment – Continued**

**SAMPLE ILLUSTRATION**

**ANY EMPLOYER**  
**THE LOCAL CHOICE HEALTH CARE PROGRAM**  
Operating Statement  
July 1, 1997 through June 30, 1998

INCOME	\$1,519,543
EXPENSES:	
Incurred Claims	\$1,417,129
Contractor Administration	128,107
MISA Capitation	55,290
Program Overhead	<u>19,017</u>
Total Expenses	\$1,619,543
GAIN OR (LOSS)	(\$100,000)

Thus, if this employer had withdrawn on June 30, 1998, the maximum adverse experience adjustment would have been the operating loss of \$100,000. However, prior year's accumulated gains could be applied to any current year loss.

Likewise, if an employer withdraws from the program and the review analysis reflects a gain for the immediate past plan year, there would be no adverse experience adjustment to the employer, even if its accumulated experience was a loss.